

Internal Revenue Service  
**memorandum**

CC:TL-N-8146-87

Brl:HFRogers

date: JUL 6 1987

to: District Counsel, Cleveland CC:CLE  
Attn: Richard Bloom, Utility Industry Counsel

from: Director, Tax Litigation Division CC:TL

subject: [REDACTED]

This is in response to your request that we reconsider our answer to issue 4 (budget billing) of our March 24, 1987, technical advice memorandum.

ISSUE

Should we continue to raise the "budget billing" issue [see Revenue Ruling 72-114, 1972-1 C.B. 124], which involves the accrual of unbilled revenue from the last meter reading date to the end of the taxable year to the extent of the excess of budget billings for the year over the customers' meter reading billings? RIRA No. 0451.19-00

CONCLUSION

Upon reconsideration, we believe that the Service should continue to raise the "budget billing" issue with respect to energy that was delivered between the last meter reading and the end of the year, to the extent that payment was received for such energy during the taxable year.

FACTS

On March 24, 1987, we provided technical advice on seven utility industry issues, including the effect of section 821(b)(3) of the Tax Reform Act of 1986 with regard to the unbilled revenue issue for taxable years beginning before August 16, 1986. There are no changes in Service position as to the

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other six issues covered by the March 24, 1987, memorandum.<sup>1/</sup> However, this memorandum is a modification of our position as to the budget billing issue. Our position in the March 24, 1987, memorandum was based on strict accrual principles of accounting. Once the gas is delivered to the customer, the customer is obligated to pay for it and the utility company should take it into income. However, since the legislation stated that the meter reading method was to be considered a proper method of accounting for taxable years beginning prior to August 16, 1986, our position was that budget billing based on meter readings should also be permitted in order to be consistent. However, budget billing based on the bills issued method was not an allowable method, so those utility companies would have to report income based on the gas delivered.

Subsequent to our March 24, 1987, memorandum, we have determined that the pre-August 1986 meter reading exception was not meant to cover budget billing. Therefore, we have modified our position, as discussed hereafter.

#### DISCUSSION

The Service should continue to raise the "budget billing" issue to the extent that energy was delivered between the last meter reading date and the end of the year, so long as payment was received for such energy during the taxable year.

The Service position regarding budget billing is summarized in Rev. Rul. 72-114, 1972-1 C.B. 124. The Revenue Ruling provides that where a taxpayer uses a monthly "budget billing" procedure:

[T]he taxpayer must accrue as income,... the monthly charges for gas actually consumed either computed on the basis of a meter reading during the taxable year or, for months subsequent to the last meter reading, by estimating the monthly charge. In addition, the taxpayer must accrue as income for such taxable year any excess of the

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<sup>1/</sup> It should be noted, however, that the Joint Committee's explanation of the provision indicates that the meter reading method is deemed to be proper only if that method was actually used by the taxpayer for the preceding taxable year, and that no inference was intended concerning whether such a method is proper if the method is retroactively adopted by the taxpayer. General Explanation 543. Hence, our conclusions regarding whether the Service must allow a taxpayer to switch to the meter reading method for pre-August 16, 1986, taxable years, and approve claims for refund, are reinforced.

amount of the budget-billings during such year over the monthly charges accruable for such year under the preceding sentence, to the extent such excess is attributable to the reasonably estimated charges for gas distributed through the last month of such year.

In Bay State Gas Co. v. Commissioner, 689 F.2d 1 (1st Cir. 1982), the court held it was an abuse of discretion for the Internal Revenue Service to require an accrual basis public utility, which used a cycle meter reading method of accounting, to accrue as income for the current year charges allocable to gas consumed by its budget billing customers between the last meter reading date in December and December 31, unless the gas actually consumed had been paid for before the year end. Accordingly, the Service should continue to raise the budget billing issue to the extent that energy was delivered between the last meter reading date and the end of the year, so long as payment was received for such energy during the taxable year. This position should be taken regardless of whether the taxpayer used the meter reading or the bills issued method of accounting. The reason for this is that the legislation was not intended to cover the budget billing issue. This was made clear in the General Explanation of the Tax Reform Act of 1986, which was prepared by the Joint Committee on Taxation. That explanation stated, in pertinent part, that "no inference is intended with regard to other questions of law, including but not limited to the treatment of prepaid income amounts for the provision of utility services at a future date, the treatment of deposits made by utility customers, or the treatment of amounts received by a taxpayer under a "budget billing" procedure." Id. at 543 (emphasis added). Consequently, our previous advice regarding the budget billing issue is hereby modified.

If you have any questions concerning this matter, please contact Helen F. Rogers at FTS 566-3521.

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